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PROJECT NO. 52373

REVIEW OF WHOLESALE ELECTRIC MARKET DESIGN	**§ § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

SOUTH TEXAS ELECTRIC COOPERATIVE, INC.'S COMMENTS ON THE COMMISSION'S WHOLESALE MARKET DESIGN POLICY QUESTIONS

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COMES NOW, South Texas Electric Cooperative, Inc. ("STEC") and submits its Comments to the Public Utility Commission of Texas ("PUCT" or "Commission") on the questions issued by Commission Staff on October 2, 2021. The deadline for filing comments in the above-styled proceeding is November 1, 2021, therefore these comments are timely filed.

I. STEC'S COMMENTS

STEC provides the following responses to the Commission's questions on wholesale market design changes. STEC also supports the comments filed by Texas Electric Cooperatives, Inc. ("TEC") in response to the Commission's questions.

1. The ORDC is currently a "blended curve" based on prior Commission action. Should the ORDC be separated into separate seasonal curves again? How would this change affect operational and financial outcomes?

If the Commission reverts back to using separate seasonal curves, STEC recommends that the Commission consider the curves holistically to ensure the cumulative effect of the curves produces the desired market signals. Changes to the ORDC should focus on generating price signals that will incent generation in the market and accurately reflect existing reliability concerns. STEC believes this can be accomplished with either a blended curve or seasonal curve approach.

2. **What modifications could be made to existing ancillary services to better reflect seasonal variability?**

The Commission should continue to monitor the reliability impact of recent policies to increase the overall amount of ancillary services procured by ERCOT. Increasing the amounts of ancillary service products that support dispatchable generation resources during high net load periods in summer and winter peaks and could better address seasonal variability concerns. The Commission should also monitor the performance of loads as they are integrated to more fully participate in demand response and ancillary service products. Analysis of load response during Winter Storm Uri showed mixed results in terms of benefits to system reliability, including decreased participation by loads when they were more likely to be called upon to deploy. Until demand response performance is consistently shown to perform reliably, the Commission should cautiously approach increasing its dependence on load participation in the Ancillary Service markets as a reliability tool.

3. **Should ERCOT develop a discrete fuel-specific reliability product for winter? If so, please describe the attributes of such a product, including procurement and verification processes.**

    a. **How long would it take to develop such a product?**
    b. **Could a similar fuel-based capability be captured by modifying existing ancillary services in the ERCOT market?**

STEC supports Commission efforts to ensure that generation resources that provide enhanced reliability benefits to the system, such as dual fuel capability and firm fuel supply (including coal stockpiles, firm natural gas transportation and supply, and onsite storage), are adequately compensated through fuel-specific reliability ancillary services. This is consistent with the language in Senate Bill 3. The Commission could accomplish this by creating an entirely new ancillary service product or by designating a portion of existing ancillary service products to be procured only from generation resources that meet fuel-based capability requirements. The latter

option could likely be implemented quickly because it would only require slight modification to ERCOT's existing systems and processes.

4. Are there alternatives to a load serving entity (LSE) Obligation that could be used to impose a firming requirement on all generation resources in ERCOT?

Generation resource firming obligations can and should be considered separately from an LSE Obligation. A firming requirement for generation resources places the burden of ensuring available capacity on the generation resource. A firming requirement can be imposed by a financial mechanism that incents long-term deployment of dispatchable generation similar to LCRA's Resource Adequacy Adder, although STEC posits that it would benefit by tweaks to the determination of the pricing similar to what STEC proposed in its previous comments of August 16, 2021, or by a physical mechanism that requires all resources to achieve a specific Effective Load Carrying Capacity level (e.g. 95%) at the time of peak net load. By implementing a target reserve margin and developing reliability products that value reliability features, and specifically dispatchable generation, the Commission can both increase reliability and signal to the market that investment in dispatchable generation is needed in the ERCOT market.

5. Are there alternatives to an LSE Obligation that could address the concerns raised about the stakeholder proposals submitted to the Commission?

While there are features of the LSE Obligation that can be modified to improve the proposal, they cannot resolve the fundamental issue that the LSE Obligation is unlikely to accomplish the goal of incentivizing investment in dispatchable generation and improving reliability in the ERCOT market. The LSE forward obligation will not be transparent or liquid and will not provide a market signal on a forward basis of the length of time necessary for the development of new capacity.

Load Serving Entity (LSE) Obligation

6. **How can an LSE Obligation be designed to protect against the abuse of market power in the wholesale and retail markets?**

    a. **Will an LSE Obligation negatively impact customer choice for consumers in the competitive retail electric market in ERCOT? Can protective measures be put in place to avoid a negative impact on customer choice? If so, please specify what measures.**

    Not addressed.

    b. **How can market power be effectively monitored in a market where owners of power generation also own REPs that serve a large portion of ERCOT's retail customers?**

As discussed in more detail in response to subsection (d), initiating a process for the IMM, ERCOT, or PUCT to review bilateral transactions is fraught with potential problems. Further consideration of how market power in the bilateral market will be overseen is needed before an LSE Obligation proposal is decided upon. Approximately 90% of the ERCOT market trades bilaterally and is only scheduled through the market, with varying degrees or firmness for products, security, tradability and ties to physical generation. This would be a regulatory requirement applicable to arms-length transaction if bilateral agreements must be examined to support the LSE Obligation.

    c. **What is the impact on self-supplying large industrial consumers who will have to comply with the LSE Obligation and will it impact their decision to site in Texas?**

Consideration of any financial impact to large-industrial consumers should be balanced with the impact on residential customers subject to load shed. A failure to maintain a reliable electric system will be the greatest deterrent to large-industrial consumers choosing to site or remain in Texas. Large-industrial consumers should pay their fair share of costs associated with maintaining a reliable electric system and consideration of those costs should be on par with consideration of cost increases for residential and other consumers.

d. What is the impact of an LSE Obligation on load-serving entities that do not offer retail choice, such as municipally owned utilities or electric cooperatives?

As a G&T electric cooperative serving nine distribution Members, STEC takes a conservative approach to determining its load forecast and procuring a forward supply of generation. Because of this conservative approach, STEC was able to serve its load during Winter Storm Uri without causing financial disruption for its Members or the market as a whole. STEC cautions the Commission from implementing an LSE Obligation that is dependent upon the LSE's estimate of load growth. STEC relies on multiple data points to project future load growth and STEC retains flexibility in adjusting those projections. If other market participants are "locked in" to a static or inaccurate load forecast that will be detrimental to STEC and other market participants that have realistic load forecasts, then subsidization of the market will occur by LSEs who have a long position because of their more accurate forecasting. For STEC to be able to take advantage of its own reserves, other market participants must be required to supply objective quantities of reserves. Therefore, this reality exposes the need for a true-up mechanism to compensate those with a long capacity position so that those with an inherent or deliberate short capacity position do not receive subsidization in the market.

STEC has concerns that a new LSE forward obligation could interfere with STEC's existing contractual obligations if such contracts are subject to review or oversight by the Independent Market Monitor ("IMM"). PURA is clear that contracts are not to be abrogated. The Commission has not addressed what the standards or related ramifications would be if the IMM concludes that an LSE's bilateral transaction is problematic under its standards. STEC recommends that the Commission make a clear determination that existing bilateral transactions will not be impeded by the LSE Obligation and that such agreements remain confidential and not subject to public disclosure.

e. Can market power be monitored in the bilateral market if an LSE Obligation is implemented in ERCOT? Can protective measures be put in place to ensure that market power is effectively monitored in ERCOT with an LSE Obligation? If so, please specify what measures.

A process in which the IMM, ERCOT, or the PUCT seeks to review bilateral transactions is fraught with potential problems. First, significant issues arise around the Commission's ability to require market participants to take actions that would cause them to be in violation of existing contractual obligations. Further, the Commission's authority to regulate bilateral transactions between market participants is limited. For instance, PURA § 39.158 provides the Commission direct authority to approve or deny transactions that will result in ownership of more than 20% of the generation that is produced or capable of being imported into the ERCOT market, but the Commission is granted no such authority with respect to power supply agreements between market participants, including electric cooperatives. Further consideration and much greater detail with respect to how market power in the bilateral market might be overseen is needed before an LSE Obligation proposal is approved.

f. Should the LSE Obligation include a "must offer" provision? If so, how should it be structured?

STEC assumes that this question is structured to address a "must offer" requirement of an entity's capacity to other entities under an LSE Obligation construct. An LSE Obligation should not include a "must offer" provision for generation resources. A "must offer" obligation creates an unpaid capacity requirement for generation resources. To effectively incent generation in the ERCOT market, all generation and capacity should be financially compensated in accordance with its full market value. If capacity is required to be provided, it should be through a transparent, forward market that will result in new generation being built. Furthermore, a "must offer" requirement would undermine the premise of encouraging bilateral contracting among entities in ERCOT, which has been a lynchpin of the ERCOT market since the start of the Zonal paradigm

twenty years ago. It is also unclear how an LSE might offer capacity from a bilateral energy transaction, or whether the resource that provided the energy and capacity to a third party would be allowed to deduct that sold amount from a "must offer" requirement. Lastly, certain federal contracts for hydro capacity stipulate that energy and capacity from the federally owned assets must benefit the contracting entity; such a "must offer" requirement would be at odds with those federal contracts.

If the question assumes that the "must offer" requirement is for Day Ahead Market or Real-Time Market operational use, then STEC agrees the generation should be available to ERCOT for commitment in either the Day Ahead Market or Real-Time Market if the resource is not otherwise self-committed and is not outaged.

7. How should an LSE Obligation be accurately and fairly determined for each LSE? What is the appropriate segment of time for each obligation? (Months? Weeks? 24 hour operating day? 12 hour segments? Hourly?)

It would be difficult to assess an obligation for longer than a typical REP product period, however any forecast over a future period will be of questionable value, unless it is a reserve requirement that is a total capacity level to be met. There is no accurate and fair way to determine the LSE Obligation on a forward basis. Therefore, if the LSE Obligation is adopted, the evaluation of a LSE's compliance with such an obligation should be assessed based on their actual contribution of capacity to the peak determined by the Commission, whether it is the peak net load, peak system load or something otherwise. As such, there will need to be a true-up mechanism to allow for entities that held a long capacity position to be compensated by those who held a short capacity position in order to prevent subsidization and gaming in the market.

8. Can the reliability needs of the system be effectively determined with an LSE Obligation? How should objective standards around the value of the reliability-providing assets be set on an on-going basis?

a. Are there methods of accreditation that can be implemented less administrative burden or need for oversight, while still allowing for all resources to be properly accredited?

STEC suggests that accreditation should be as granular as possible and conducted at the resource level, however, STEC understands that it may be necessary to create buckets of resources to expedite the analysis. If buckets of resources are necessary, STEC urges that the Commission direct that the accreditation be completed in buckets that have resources of the same technology type and within the same geographical regions.

b. How can winter weather standards be integrated into the accreditation system?

STEC recommends that a reserve margin be established as a necessary component of determining system reliability needs. Regardless of whether an LSE Obligation is implemented, objective standards for valuing reliability-providing assets, including winter weatherization features, could be modeled on the procurement of Black Start services. To provide Black Start services in the ERCOT market, generation resources must meet specific enhanced reliability requirements and operators must undergo specialized Black Start training. In the same manner, the Commission and ERCOT could identify a reliability-specific need, the weatherization or other requirements needed to fulfil the need over a multi-hour or multi-day time period, and then establish procedures for ERCOT to verify that such requirements have been satisfied by generation resources. Such a service should be spread across the geographic footprint of ERCOT as much as possible.

9. How can the LSE Obligation be designed to ensure demand response resources can participate fully and at all points in time?

STEC supports the comments filed by TEC in response to this question.

10. How will an LSE Obligation incent investment in existing and new dispatchable generation?

STEC supports the comments filed by TEC in response to this question.

11. How will an LSE Obligation help ERCOT ensure operational reliability in the real-time market (e.g., during cold weather events or periods of time with higher than expected electricity demand and/or lower than expected generation output of all types)?

STEC supports the comments filed by TEC in response to this question.

12. What mechanism will ensure those receiving revenue streams for the reliability services perform adequately?

PURA § 15.023 provides the Commission authority to impose administrative penalties for violations of Commission rules and ERCOT Protocols, including the authority to assess penalties of up to $1,000,000 for a violation of weather emergency preparedness standards. The Commission has ample tools to enforce violations of reliability standards. STEC urges the Commission to ensure that any new or modified reliability service products or ancillary service products include clearly defined, objectively measurable performance standards. Whether performance is determined by a metric that is measured over a period of time or a one-time obligation, the requirements should allow for generation and load resources to have a clear understanding of the performance obligation, and at the same time should not be so punitive so as to discourage participation thereby muting the intended effect of the reliability service. This will assist the Commission, ERCOT, and market participants in ensuring that reliability services are performed adequately.

13. What is the estimated market and consumer cost impact if an LSE obligation is implemented in ERCOT? Describe the methodology used to reach the dollar amount.

While STEC has not estimated the cost impact of an LSE Obligation, STEC asserts that the costs will be significant and may outweigh any benefits of implementing the proposal. The LSE Obligation "look ahead" window of three years does not provide enough lead time to properly

incent generation in the market and is dependent on LSE's modeling expected growth at levels that will increase their costs. It is a suboptimal tool that is designed to provide the reliability benefits of a centralized forward capacity market, but it does not provide the market transparency and liquidity of a centralized forward capacity market. Thus, the cost to consumers will be greater than that of a fully implemented centralized forward capacity market and will be greater than the direct cost incurred by procuring power to satisfy a forward obligation. Consumers will also pay the opportunity cost of not implementing a more efficient market design reform that would provide greater reliability and more transparency in price signals.

14. How long will the LSE Obligation plan take to implement?

The timeframe for implementing an LSE Obligation is difficult to predict without more details concerning how the forward obligation will be determined, what level of oversight the IMM and ERCOT will have over bilateral agreements, and whether or not reliability products are created as part of the LSE Obligation market design changes. STEC continues to urge the Commission to take a deliberative approach to implementing market design changes, possibly doing so as a separate project. STEC agrees with TEC that the intent of SB3 will have been with ORDC changes and the proposed changes to the AS markets and therefore more time can be allocated to discern whether and how to implement a LSE Obligation.

15. If the Commission adopts an LSE Obligation, what assurances are necessary to ensure transparency and promote stability within retail and wholesale electric markets?

As noted in STEC's previous responses, it is imperative that market design changes are targeted to meet a reserve standard and increase price signals to meet that standard, with particular focus on incentivizing investment in dispatchable generation. This focus should be the primary driver of market redesign policies in order to enhance reliability and market stability.

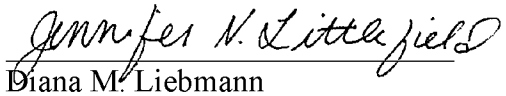
16. Are there relevant "lessons learned" from the implementation of an LSE Obligation in the SPP, CAL-ISO, MISO, and Australian markets that could be applied in ERCOT?

Not addressed.

II. CONCLUSION

STEC appreciates the opportunity to provide comments to the Commission on these important issues.

Respectfully submitted,



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PROJECT NO. 52373

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SOUTH TEXAS ELECTRIC COOPERATIVE, INC.'S EXECUTIVE SUMMARY

- STEC urges the Commission to reject the LSE Obligation proposal and instead implement a target reserve margin and specific reliability products designed to incent investment in dispatchable generation resources.
- An LSE Obligation should not supplant an electric cooperative's decision making authority to make the best fuel supply decisions.
- If an LSE Obligation is adopted, LSEs should have the capability to provide information to support adjustments to the calculation of the LSE's load share ratio of forecast net peak load, but such amounts ultimately must be objectively quantified.
- The Commission should not take any actions that would impede on existing bilateral power supply contracts, such contracts should remain confidential, and arguments should not be subject to public disclosure.
- The role of the IMM, ERCOT, and the PUCT in overseeing market power issues in the bilateral market needs further consideration before an LSE Obligation could be approved.
- Any changes to the ORDC should result in increased price signals for dispatchable generation. Changes to the ORDC curves should be viewed in the aggregate, not separately.
- By implementing a target reserve margin and developing reliability products that value specific reliability features provided by dispatchable generation, the Commission could both increase reliability and signal the market that investment in dispatchable generation is needed in the ERCOT market.
- The Commission can modify existing ancillary service products to tailor the products to generation resources with the ability to dispatch over longer periods due to specific fuel sources.
- An LSE Obligation should not include a "must offer" provision for generation resources because it will create an unpaid capacity requirement for generation resources.
- The LSE Obligation proposal is less efficient than a capacity market design because the LSE Obligation is less transparent, less liquid, and does not provide enough lead time in its market signals to adequately incent new generation.
- The Commission should refrain from acting on the LSE Obligation proposal until after the Brattle Group's study is completed before potentially modifying the ORDC, HCAP, VOLL, and MCL.

- Wholesale changes to the market are best done with a comprehensive, holistic studied approach with full opportunity for stakeholder input.